SYFX Treasury Foundation

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- Weekly Market Update
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US Data : Highs and Lows

- Data from last week consisted of a series of highs and lows- Lingering supply chain issues, rising prices and still-strong consumer demand
- Week began on a positive note, as new home sales increased 14% to a 800K-unit pace last month following existing home sales, which rose 7% previous week. Completed homes rose to a six-month-high, reaching a 207K-unit pace, and price growth subsided to a still-elevated 18.7% year-over-year increase in September, down from 23.3% the prior month
- The first gain in consumer confidence in three months was another early-week upside surprise. The increase was due to renewed optimism around both consumers' present situations and expectations for the future, which bumped the headline four points to 113.8.
- Chicago PMI surprisingly moved further into a level depicting expansion (a reading above 50). The index rose to 68.4 in October from September's 64.7 reading, versus estimates calling for a decrease to 63.7.
- Q3 GDP growth however was only 2.0%, as the growing trade deficit proved to be a drag on growth. After two consecutive quarters of inventories being a drag on growth, they added 2.1 points and were the only reason growth did not stagnate . PCE deflator rose at a 5.3% annualized rate in the third quarter. That boosted the year-over-year rate of consumer inflation to 4.4%—the highest in over 30 years.
- Total unfilled orders rose for the eighth consecutive month in September, while backlogs of core capital goods rose to a record high of $235B. This is consistent with the recent uptrend in the ISM supplier deliveries index. The manufacturing sector has been struggling with rising backlogs and wait times, as there are still bottlenecks at the nation's largest ports—in recent days, over 70 container ships have been idling in the ports of Los Angeles and Long Beach as they wait to unload their products.
- Goods spending fell 9.2% in the third quarter as the PCE deflator rose to its 4.4% year-over-year, its highest rate in over 30 years.

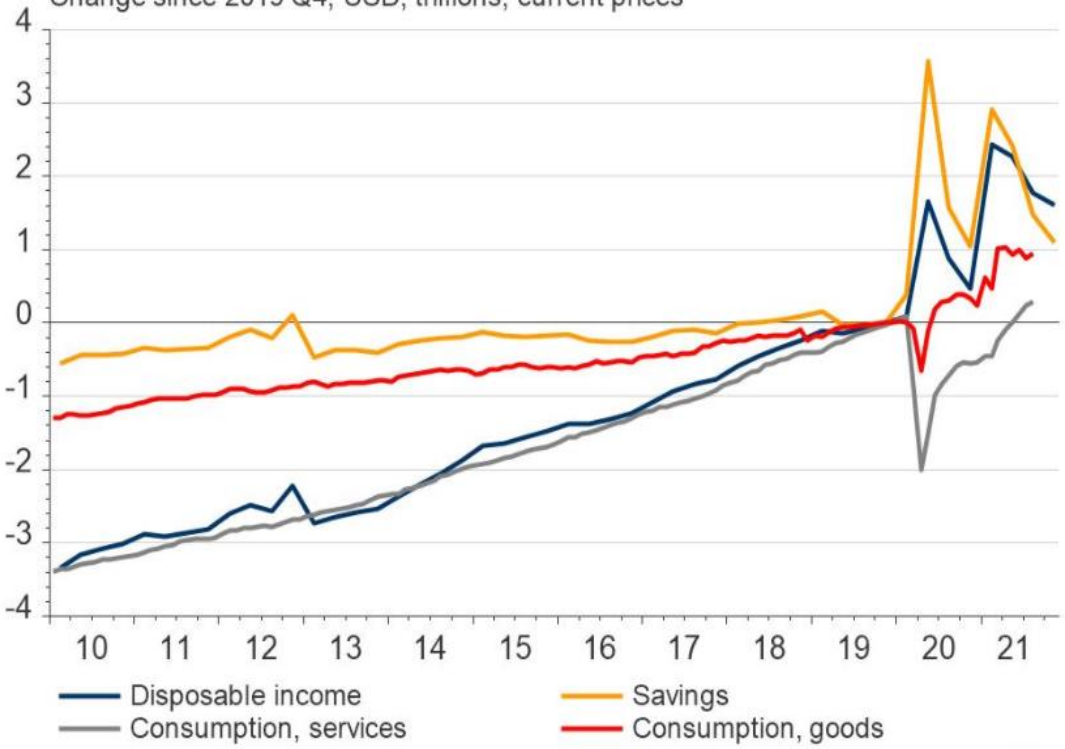
October – Defied Seasonals

- While history often points to October as a volatile month for equities, this year was the opposite in equity markets. After a 5.2% correction in September, markets were up nicely in October- its best monthly rally since November 2020 - with S&P 500 returning an impressive 6.6% for the month and up over 1.0% last week.
- This was driven by both growth and value sectors, even as the 10-year Treasury yield climbed higher to 1.57% levels and despite high-profile technology names like Amazon and Apple falling short in earnings.
- Consumer discretionary shares fared best within the S&P 500 Index, boosted by a jump in Tesla shares—bringing the firm's market capitalization above USD 1 trillion—following news that rental firm Hertz Global agreed to buy 100,000 of its electric vehicles.
- For now, profit margins are holding up as companies have been able to offset some of the higher input costs associated with rising inflation pressures through higher prices that consumers appear willing to accept at the moment due to their healthy discretionary spending capability, high savings and growing household net worth.
- Buy back flows to keep the upmove well anchored

Earnings estimates for Q3-21 have been moving higher, despite concerns around supply chains and inflation:

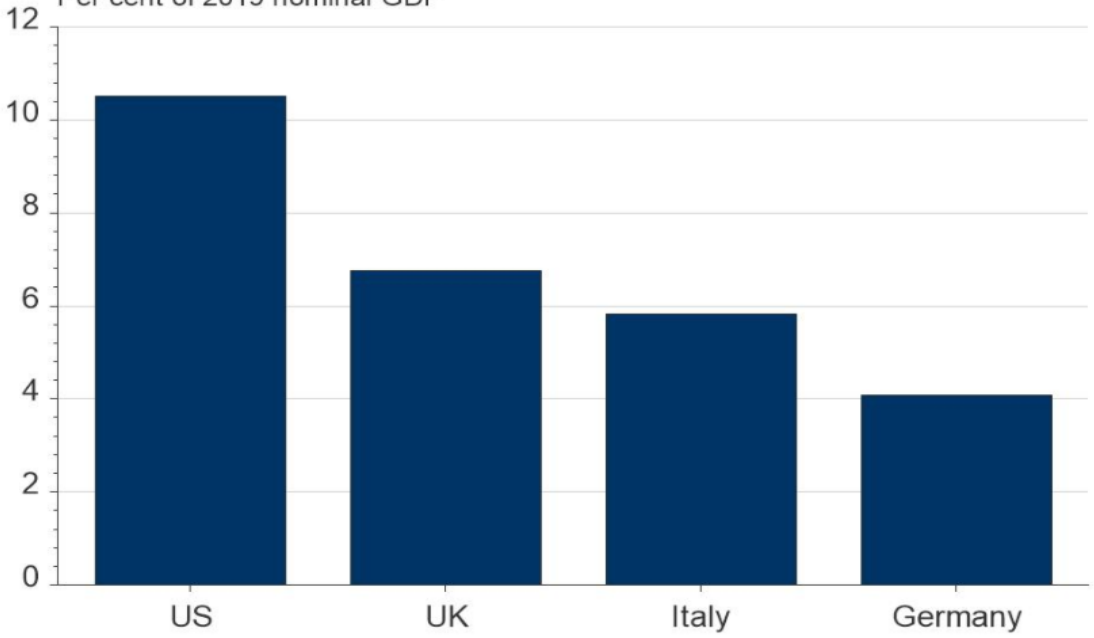
US households income account

Change since 2019 Q4, USD, trillions, current prices



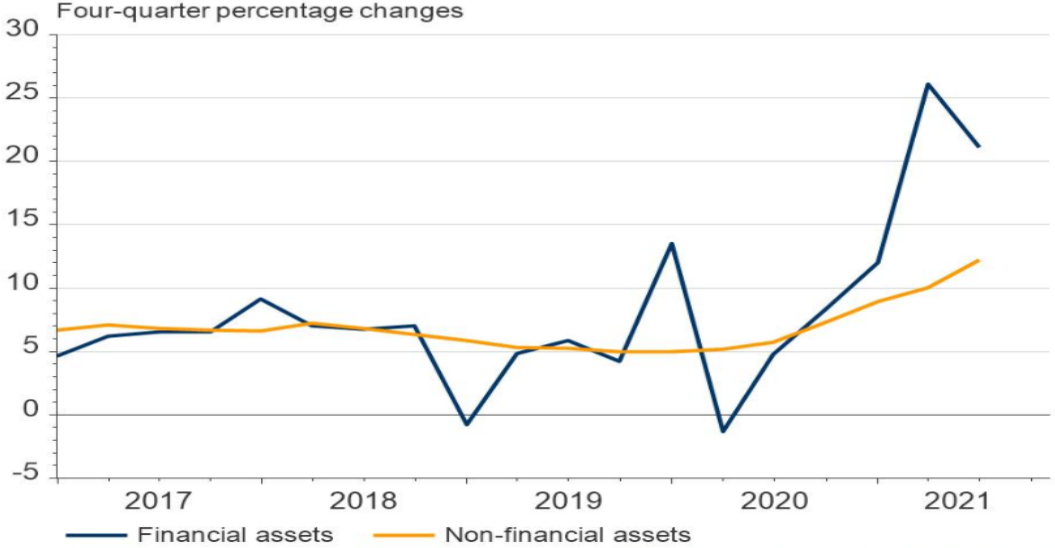
Excess household savings, 2020 Q1-2021 Q1

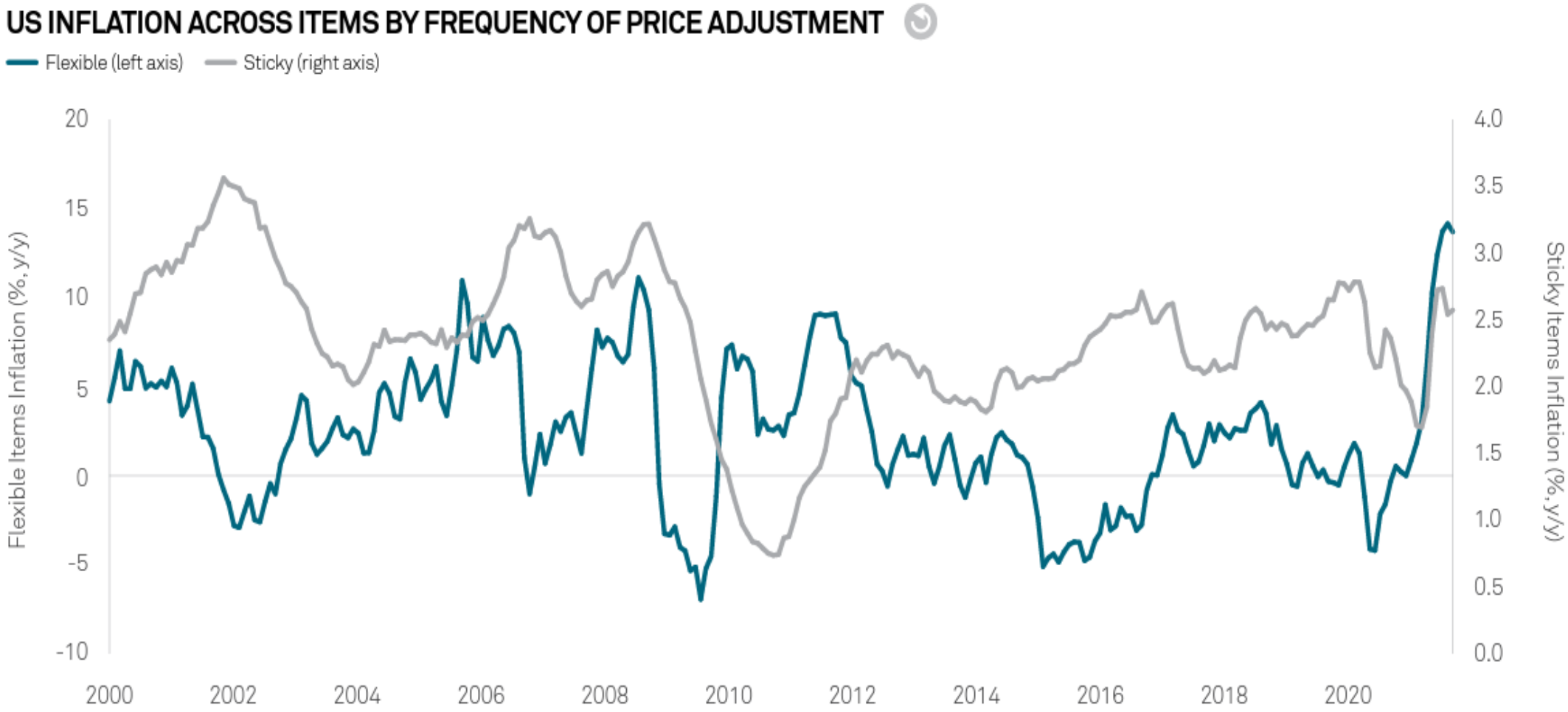
Per cent of 2019 nominal GDP



US households acquisition of assets

Four-quarter percentage changes





- The sticky price index sorts the components of the consumer price index (CPI) into either flexible (quick to change) or sticky (slow to change) categories based on the frequency of their price adjustment.
- Inflationary concerns would increase if prices for “sticky” items shifted higher.

Hawkish Drift -1/2

- The transition toward a more hawkish global central banking stance has been the unifying theme across fixed income markets.
- Rising yields at the short ed of the curve are tied to expectations that central banks across the world will be more aggressive than previously expected to address inflationary pressures.
- Australian bond market might prove to be the canary that dropped dead in the bond market last week. It was a five-sigma move, which is supposed to happen one day in every 13,932 years. In other words, it's the biggest surprise for the Aussie bond market
- Meanwhile, yields at the long end of the curve have either fallen or risen at a less aggressive pace than short-end rates . Longer dated instruments are showing less sensitivity to short end moves than usual. There does seem to be a narrative developing in US money markets that early central bank tightening means that the terminal rate for the tightening cycle is lower. Thus while the 1m USD OIS priced 1 year forward has risen 40bp over the last month, the 1m OIS priced 3 years forward is only 5bp higher over the last month and is actually 12bp lower of the last week. Yet it certainly seems dangerous to second-guess the top in the Fed cycle at this stage.
- While the FOMC is poised to announce tapering in this week, the more relevant debate in the Treasury market is how quickly the Fed will deliver on the ambitious liftoff hikes already priced into the futures market. Better-than-even odds of the June liftoff are far overstated and the Fed will err in favor of a longer window between the end of bond buying and the first hike. There is a probability of a partial reversal of the recent curve flattening should Powell be reconfirmed.
- Indeed there is much uncertainty over the terminal rates for policy cycles around the world.
- That is why dollar could be knocking on the door of big levels in November, such as 1.1500 in EUR/USD and 115.00 in USD/JPY. US energy independence should also underpin the dollar over coming weeks too.

Hawkish Drift -2/2

- Bank of Canada struck a more hawkish tone than expected at its October meeting. While it kept the policy rate steady at 0.25%, it signaled that future rate hikes could come sooner than previously expected.
- It also announced an end to its quantitative easing program. Despite revising its GDP forecasts lower for 2021 (5.1% compared to 6.0% previously) and 2022 (4.3% compared to 4.6% previously), citing supply chain disruptions, a more cautious assessment of the economy's productive potential also meant that updated projections now see the negative output gap closing by Q2-2022, earlier than its previous forecast.
- As expected, the Brazilian Central Bank raised its Selic rate 150 bps to 7.75% at its October meeting—the sixth consecutive hike—bringing the Selic rate to the highest it has been since October 2017. The BCB signaled another 150-bp rate hike was in store for December, which would bring the Selic rate to 9.25% at the end of this year.
- ECB kept monetary policy unchanged at its October meeting. Comments from Lagarde, while reasonably balanced, had a mildly hawkish bent. Lagarde indicated that this period of higher inflation should last longer than initially expected but should ultimately prove temporary

	Central bank key interest rate (as %)							
Period	United States	Canada	United Kingdom	Euro zone	Sweden	Japan	Australia	South Korea
2002-2007	2.89	3.11	4.48	2.68	2.80	0.10	5.38	4.00
2008-2009	1.17	1.74	2.66	2.57	2.39	0.28	4.98	3.44
2010-2015	0.25	0.87	0.50	0.65	0.82	0.08	3.35	2.49
2015-2019	1.21	1.00	0.51	0.01	-0.40	-0.02	1.60	1.47
2020-2021	0.41	0.42	0.17	0.00	0.00	-0.03	0.22	0.64

	Inflation (CPI, Y/Y as %)							
Period	United States	Canada	United Kingdom	Euro zone	Sweden	Japan	Australia	South Korea
2002-2007	2.7	2.2	1.8	2.2	1.4	-0.2	2.8	2.9
2008-2009	1.8	1.3	2.9	1.8	1.6	0.0	3.1	3.7
2010-2015	1.7	1.7	2.4	1.5	0.8	0.5	2.4	2.1
2015-2019	1.6	1.7	1.5	1.0	1.3	0.5	1.6	1.1
2020-2021	2.4	1.7	1.3	1.0	1.0	-0.2	1.6	1.2

	Central bank key interest rate (as %)							
Period	Mexico	Brazil	Chile	Argentina	Turkey	Poland	South Africa	Nigeria
2002-2007	7.24	17.61	3.74	14.41	-	5.68	9.33	8.68
2008-2009	6.67	11.30	4.55	10.46	-	4.75	10.00	8.78
2010-2015	4.27	10.50	3.81	13.70	6.62	3.21	5.61	10.58
2015-2019	4.00	10.09	2.87	36.04	11.87	1.43	6.58	13.41
2020-2021	4.00	3.27	0.82	26.40	13.90	0.34	3.97	12.12

Period	India	Russia	China	Indonesia	Malaysia	Vietnam	Thailand
2002-2007	6.01	14.74	3.50	10.36	2.98	5.55	2.58
2008-2009	6.47	11.13	3.27	7.91	2.79	8.82	2.25
2010-2015	7.31	8.16	4.26	6.72	2.93	5.88	2.18
2015-2019	6.38	8.54	3.70	5.79	3.12	2.97	1.50
2020-2021	4.18	5.16	2.76	3.96	1.86	0.91	0.55

	Inflation (CPI, Y/Y as %)							
Period	Mexico	Brazil	Chile	Argentina	Turkey	Poland	South Africa	Nigeria
2002-2007	4.3	7.4	2.9	12.4	17.4	2.0	5.3	12.3
2008-2009	5.2	5.3	4.6	17.9	8.4	3.8	9.1	12.1
2010-2015	3.7	6.4	3.1	25.7	8.0	1.7	5.2	10.4
2015-2019	4.0	5.7	3.1	36.4	11.7	0.9	5.0	12.9
2020-2021	4.2	5.1	3.4	44.5	14.4	3.8	3.7	15.0

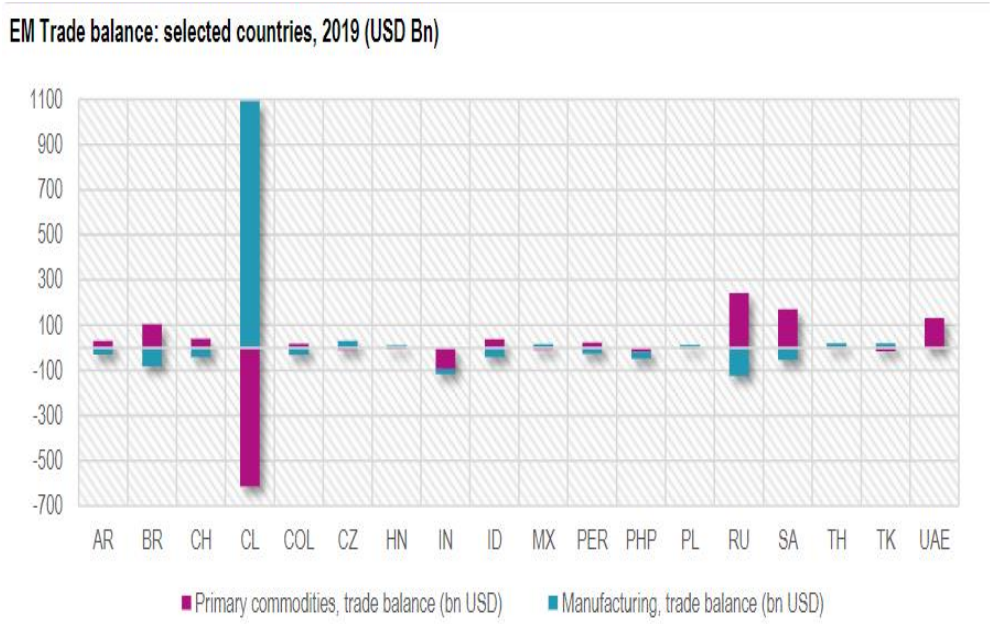
Period	India	Russia	China	Indonesia	Malaysia	Vietnam	Thailand
2002-2007	4.9	11.9	2.1	9.1	2.2	6.5	2.8
2008-2009	5.5	12.8	2.6	7.2	3.0	15.0	2.3
2010-2015	8.5	8.4	2.9	5.6	2.3	8.1	2.2
2015-2019	4.2	6.7	2.0	4.0	1.9	2.6	0.3
2020-2021	6.0	4.6	1.7	1.8	0.32	2.5	-0.1

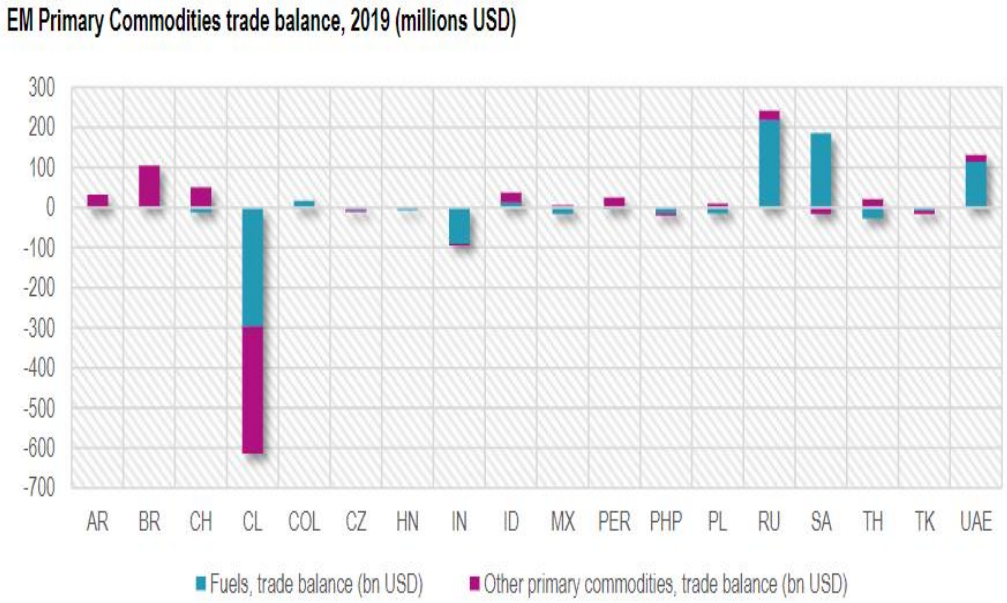
UN Food and Agricultural Price index

Historically, elevated food prices are a sign of upward inflationary pressure and a risk particularly to emerging markets.

EM : Winners and Losers

- A revived demand and need for energy generation, coupled with supply constraints, have been instrumental in the recent acceleration of energy prices, that have fed into global inflationary pressures and, not less importantly, seem to be potentially triggering an economic growth shift from emerging energy-importing countries to emerging energy-exporters
- For those EMs that have a big manufacturing sector, high energy cost will translate into higher producer prices and lower profit margins. Those EMs that are net metal and agricultural exporters, the impact of such rise is mixed.
- China stands by far as the biggest commodity importer posting a net primary deficit of USD 613bn followed by India (-USD 94.6bn), the Philippines (-USD 19bn), Turkey (-USD 14.9bn), Czech Rep. (-USD 9.8bn), Mexico (-USD 8.8bn), Hungary (-USD 5.13bn), Thailand (-USD 5bn) and Poland (-USD 3.87bn).
- Of these economies, China ($1091.5bn), Czech ($29.9bn), Thailand ($20.3bn), Turkey ($19.3bn), Mexico ($16.8bn), Poland ($12.5bn) and Hungary ($10.6bn) post net manufacturing surpluses, meaning these economies will endure the pain of higher commodities prices per se, but also higher input and production costs on the manufacturing sector that derive from the current global supply chain disruption.
- Higher costs meaning shrinking profit margins.
- On the other side, top net commodity exporters are Russia, Saudi Arabia, the United Arab Emirates with surpluses of $241.5bn, $170.2bn and $132.2bn respectively, followed by Brazil ($105bn), Chile ($40.3bn), Indonesia ($37.7bn), Argentina ($31.4bn), Peru ($23bn) and Colombia ($17bn).





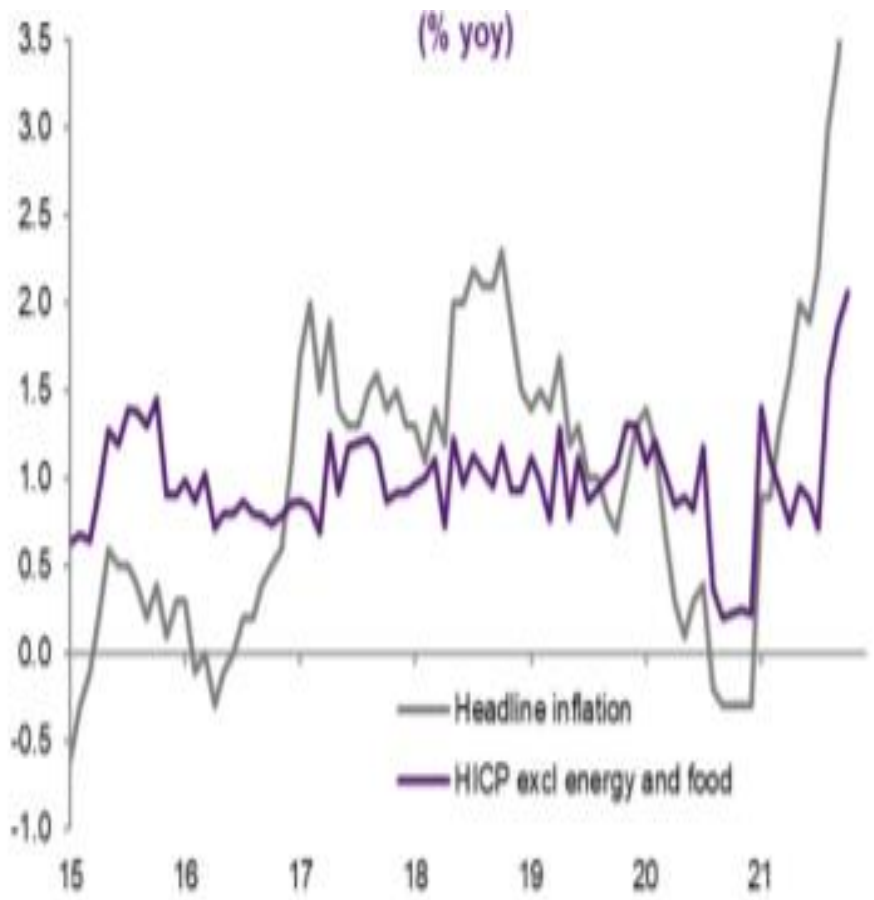
Next Supply shock

- Supply chain woes have dominated headlines throughout the 2021 calendar year, with the ongoing global microchip shortage heavily impacting auto industry production .Now, there are rumblings that further issues may arise with a magnesium shortage in China.
- About 87 percent of global magnesium production comes from China and much of that comes from Yulin City in Shaanxi Province. But due to the energy crisis, production restrictions have been imposed on many factories there. Of the fifty magnesium factories, only fifteen are still active. They also run at half power to meet the energy requirements. It will remain that way at least until the end of the year.
- Current Chinese magnesium shortage could impact automakers with a wide-sweeping shortage of aluminum. Magnesium is required in aluminum production as an alloying agent, which means if there is a substantial magnesium shortage, aluminum production could stop as a result. Aluminum is used for a wide variety of automotive components, offering high strength and low weight. Just a few examples of aluminum car components would include wheels, vehicle bodies and frames, engine components, and transmission components.
- German and European car industry, almost completely dependent on China for magnesium, may not get nothing in November.
- The cost of magnesium has skyrocketed, with today's remaining imports trading at what has been described as "extortionate prices" of around $14,000 per metric ton, up from around $2000 earlier this year, "making it almost impossible for European companies to produce or source magnesium-containing materials at a viable level"

EZ Inflation : Persistent

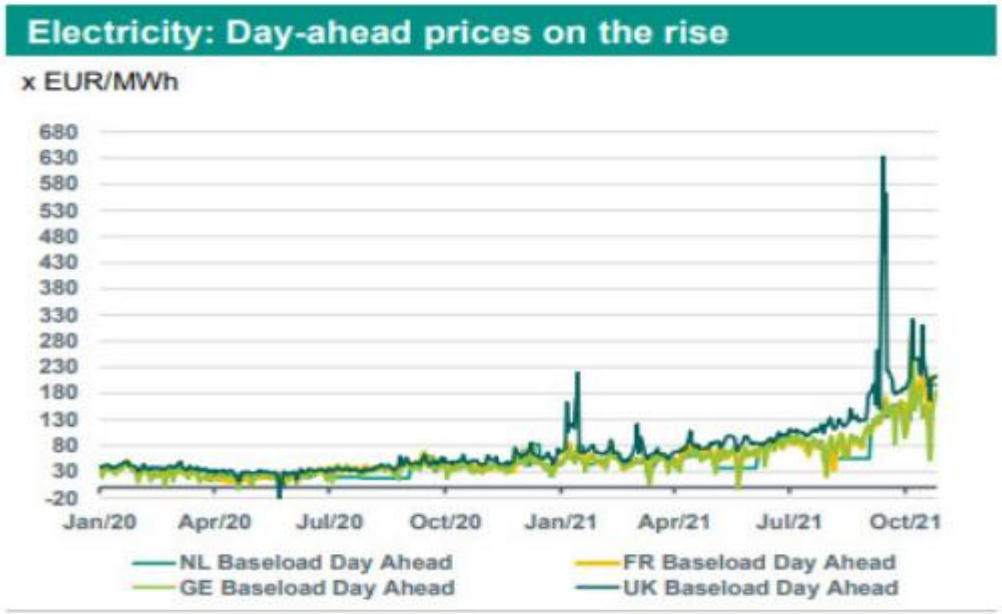
- Inflation keeps rising with headline inflation at 4.1% yoy in October after 3.4%.
- Core inflation edged higher to 2.1% after 1.9%, showing that it is energy prices that are pushing inflation higher at this stage.
- Wage dynamics will be an important determinant for the question whether the current inflation spike will also lead to more permanent price pressures, as wages constitute an important driver of services (and core) inflation.
- ECB and markets will therefore keep a close eye on the upcoming German wage bargaining rounds in 2022 for signs of rising underlying inflation pressures.
- In particular, the big rounds for the chemical industry (March), metal and electronics industry (September) and public sector (December) will be key to watch.
- However, timing-wise this also suggests that a clearer picture on the outlook for German wages (and inflation) might only really start to emerge in H2 22

Euro area headline and core inflation



Energy Crisis : No respite

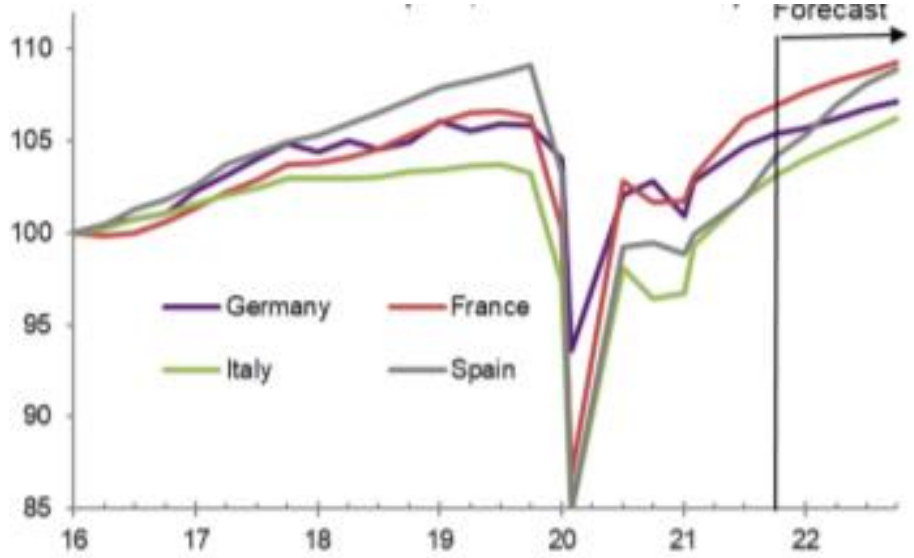
- Almost all drivers affecting electricity prices are currently creating upward price pressures.
- Natural gas prices had been trading around record highs. The price of coal has reached its highest point since 2008.
- Furthermore, the price of EU ETS (Emission Trading Scheme / CO2 rights) is still hovering around EUR 60/tonne, a level that is only 10% below the record of EUR 65.77/tonne of 28 September. If we add to this the fact that wind energy yields were disappointing this year, and thus created more demand for fossil fuels, then the sharp increase in the price of electricity is easy to explain.
- Ahead of the Climate Summit in Glasgow (31 October until 12 November), it seems that parties are taking profits on their (speculative) positions in EU ETS / CO2 rights. The increase in the use of coal fired power plants compared to gas fired power plants actually creates more demand for EU ETS rights and should push the price higher. This is not surprising since a coal plant emits more CO2 than a gas plant.
- Nevertheless, the price has stabilized in recent weeks and even appears to be declining somewhat. This could have to do with the confidence in the 'Fit-for-55' plans and the sustainability or necessity thereof, now that other countries are also announcing their more ambitious climate plans.



Eurozone : Q4 Slowdown

- Euro area expanded by 2.2% during the third quarter, getting the economy back into touching distance to its pre-pandemic level of activity. France has now broadly regained its pre-pandemic level, while Germany remains 1.1% below its pre-pandemic level, Italy 1.4% and Spain 6.6%.
- The differences in the strength of the recovery at this stage reflect difference in the exposure to supply side bottlenecks and, in the case of Spain, sub-par activity in tourism.
- Indeed, Q3 was the first whole quarter during which growth was not weighed down by any lockdown measures, which ended around mid-May in most countries. This implies that there was an upward base effect in quarterly growth in Q3, particularly in private consumption growth and in the production of services. Looking beyond Q3, the evidence has been building that growth will slow down significantly in the final quarter of the year, probably to levels well below 1% qoq.
- Besides the monthly economic activity data, high frequency data, such as the German Bundesbank's weekly activity index for the German economy and Google mobility data for visits to retail and recreation in the six largest eurozone countries also point in the direction of a significant slowdown in growth in Q4. Indeed, visits to retail and recreation have declined in October, compared to September, which was the first monthly decline since the end of the lockdowns.
- Finally, survey results, such as the composite PMI, have declined non-stop in every month since July, which also is consistent with slower growth in Q4.

GDP Real Index Q1 2008=100



Google Mobility Trends visitors to retail and recreation

% mom

Source: Our World in Data

Bond markets – Pain builds

- RBI has been setting high cutoff rates at its variable rate reverse repo auctions lately and has also resorted to a 28-day variable rate reverse repo operation to absorb some liquidity from the banking system. The increased tenure of the RBI's liquidity management operations indicated it was moving towards absorbing liquidity on a durable basis and setting the stage for a reverse repo hike.
- Certain sections of the market expect the central bank to hike the reverse repo rate by as early as December.
- The big blow is that while the market has been holding on for an open market operation for a while now, sentiment turned as other central banks are looking to tighten both policy and balance sheets
- The lack of announcement of a special open market operation and discontinuation of GSAP in October, which RBI had used to cap benchmark yields effectively in the first two quarters, led to markets taking short bets on the 6.10%, 2031 bond.
- The fall in the 10-year benchmark led to a slump in other gilts as well, after the auction result. The yield on the 14-year benchmark 6.67%, 2035 bond tracked the rise in the 6.10%, 2031 bond's yield as dealers were of the opinion that similar factors would influence the two gilts in the near term.
- The five-year (benchmark) has been protected because it is a crowded trade and people have held on, but eventually the repricing will happen and there is a lot of scope for the yield to go up further.
- 10-year benchmark 6.10%, 2031 bond ended at 97.93 rupees or 6.39% yield. The path of least resistance is on the upside for yields and there is no stopping this upmove tlll about 6.75 %

Equities : Consolidation

- Moving in tandem with the Asian markets, Indian Bourses remained negative for the second consecutive week with the DIIs turning net sellers for the first time this month since March'21.
- FIIs have net sold Indian shares worth $1.5 bln so far in October, as per provisional data, after having remained net buyers for two straight months.
- On the other hand, DIIs have net bought domestic shares worth Rs 26 bln in October so far, which is sharply lower than the past three months.
- Optimism on Indian bourses also got dampened with several international brokerages downgrading their outlook on Indian equities citing unfavorable risk-reward.
- Consolidation between 17630 17930 zone is more likely in this week

Nifty in 17630-17930 Range

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